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No. 152

Supreme Court of the United States.

OCTOBER TERM, 1942.

EVERIT B. TERHUNE ET AL., EXECUTORS UNDER THE WILL OF WILLIAM L. TERHUNE,
Petitioners,

v.

WILLIAM M. WELCH, COLLECTOR.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

AND

BRIEF IN SUPPORT THEREOF.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The undersigned, on behalf of Everit B. Terhune *et al.*, executors under the will of William L. Terhune, pray that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the First Circuit, rendered on March 23, 1942, in the case of William M. Welch, Collector (Defendant, Appellant), *v.* Everit B. Terhune *et al.*, Executors (Plaintiffs, Appellees).

Opinions Below.

The opinion of the Circuit Court of Appeals is reported in 126 Fed. (2d) 695. The opinion of the District Court of the United States for the District of Massachusetts is reported in 39 Fed. Supp. 430.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on March 23, 1942 (R. 56). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925. The action to which this petition relates is an action against the Collector of Internal Revenue to recover a tax unlawfully assessed and collected.

Question Presented.

The question stated generally is whether, under Section 302 (d) of the Revenue Act of 1926 as it stood before its amendment by Section 805 of the Revenue Act of 1936, the corpus of a trust established during his lifetime in 1929 by the plaintiffs' testator, William L. Terhune, is properly included as part of the gross estate of the decedent to measure an estate tax by reason of the existence of a clause in the instrument creating the said trust under which the trust might be terminated or amended by the trustees (of whom the settlor was one) and beneficiaries entitled after the decedent's death to all of the income if they survived him and to approximately five-sixths of the principal if they survived him for ten years.

Statement of the Case.

In 1929 the decedent, William L. Terhune, a widower seventy-nine years old, was about to contract a second marriage with a woman who was younger than his three children born of his first marriage (R. 37). For the purpose of so arranging his affairs that no friction would develop between his children and the second wife (see the opinions

of the District Court (R. 37) and of the Circuit Court of Appeals (R. 48)), he transferred the principal portion of his estate (R. 38) to a trust, of which the settlor, William L. Terhune, his son and a son-in-law were the trustees, and the latter two persons were the trustees after his decease. The income was to be paid to the decedent for life. Provision was made for the second wife, but was conditioned on her being the decedent's widow (R. 14, 17), and therefore became void in 1931, since she was divorced from the decedent in that year (R. 36), whereupon he married for the third time (R. 37). After the decedent's death, income was to go to his three children for ten years, when they were to receive all the principal except $70,000 (R. 15). His children's issue were to take parent's share if any of them should die before the principal became distributable.

Clause 12 of the trust instrument read as follows (R. 21): "This Trust may be terminated or amended at any time, but only with the written consent of the three Trustees herein named, and of any Trustee appointed by William L. Terhune under clause 14 hereof, or the survivors or survivor of them, and of the then surviving children of the said William L. Terhune." Clause 14 (R. 22) gave the decedent the right "to appoint another co-trustee to act with the three herein named, . . ." No such co-trustee was ever appointed.

The decedent died on February 23, 1936. His three children survived him. The corpus of the trust at the time of the decedent's death was valued at $394,506.27 (R. 35), and his own estate was valued at about $40,000 (R. 34). The Commissioner of Internal Revenue, relying on Section 302 (c) and 302 (d) of the Revenue Act of 1926, required the inclusion of the full value of all interests in the trust property in the decedent's gross estate (R. 25-28). The executors paid a deficiency tax of $56,542.53 with interest (R. 35) and brought suit for its recovery against the Collector

of Internal Revenue in the District Court. The District Court gave judgment for the taxpayer, holding that neither ground asserted by the Commissioner warranted the tax (R. 43). The Collector appealed (R. 44). In his argument on appeal, the Collector relied on Section 302 (d) and on that part of Section 302 (c) dealing with transfers intended to take effect in possession or enjoyment at or after death (R. 56).

The Circuit Court of Appeals reversed the judgment in favor of the taxpayer on the ground that Section 302 (d) applied, but did not expressly pass on the point raised under Section 302 (c) (R. 56).

Statutes Involved.

The statutes involved are Section 302 of the Revenue Act of 1926 (as it stood before its enactment by Section 805 of the Revenue Act of 1936) and its sub-section (d) (c. 27, 44 Stat. 9, 70, 71). The material portions read as follows:

> "Sec. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated— . . .
>
> "(d) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. . . ."

Specifications of Errors to be Urged.

The petitioners submit that the Circuit Court of Appeals erred—

(1) in failing to follow the reasoning in *Helvering* v. *City Bank Farmers Trust Co., Trustee,* 296 U.S. 85, by failing to hold in accordance therewith that Congress had not created by Section 302 (d) a fictitious status by which the property transferred by trust in the instant case was rendered includable for estate tax purposes as part of the estate of the deceased settlor;

(2) in failing to follow the case of *Helvering* v. *Helmholz,* 296 U.S. 93, by failing to hold in accordance therewith that no interest in the property transferred by trust in the instant case was rendered includable for estate tax purposes as part of the estate of the deceased settlor by Section 302 (d);

(3) (alternative to or in addition to points (1) and (2)), in failing to hold that the interest of none of the three children of the deceased in the trust property was rendered includable for estate tax purposes as part of the estate of the deceased settlor by Section 302 (d);

(4) by failing to hold that, since any power in the settlor to change enjoyment was lodged in him only in his capacity as trustee, Section 302 (d) did not render the trust property includable for estate tax purposes as part of the estate of the deceased settlor (*Nicholson* v. *United States,* 25 Fed. Supp. 424, and decision of District Court in instant case);

(5) in holding Section 302 (d) of the Revenue Act of 1926 applicable to the trusts in question;

(6) in reversing the judgment of the District Court.

Reasons Why the Writ should be Granted.

1. The Circuit Court of Appeals has in this case decided a federal question in a way probably in conflict with appli-

cable decisions of this Court in holding that Congress has, by Section 302 (d) of the Revenue Act of 1926, through setting up a presumption or a "fictitious status under the guise of supposed necessity" (City Bank case, p. 92), provided that the property here settled in trust can be regarded as part of the estate of the deceased settlor so that such property can be used to measure the estate tax, in direct contradiction to the combination of actualities in this case, as follows:

(*a*) No change in enjoyment of the trust property could have been made without the consent of the three owners of practically the entire beneficial interests in the property; plus the assent of a fourth person, a trustee.

(*b*) The deceased could have participated in any change in the enjoyment of the trust property only in a fiduciary capacity, as one of three trustees under a duty to act with the utmost good faith and only in the interest of all the beneficiaries.

(*c*) The two trustees other than the deceased whose consent to any change of enjoyment was necessary would have had to participate therein in a fiduciary capacity as trustees of the property under a duty to act with the utmost good faith and only in the interest of all the beneficiaries.

(*d*) The value of the settlor's property at the date of his death was approximately one-tenth of the value of the corpus of the trust.

(*e*) The purpose of the trust has been found by the District Court and repeated by the Circuit Court to have been to avoid certain anticipated friction, and therefore not to evade or even to avoid estate taxes.

2. The Circuit Court of Appeals has decided erroneously an important question of federal law considered in the case of *Helvering* v. *Helmholz* and the case of *Helvering* v. *City Bank Farmers Trust Co.* relating to the nature, the scope

and extent of the power to change the enjoyment of property transferred by trust by a decedent which will cause the value of such property under the provisions of Section 302 (d) of the Revenue Act of 1926 to be used to measure a tax on the estate of a decedent, which question should be settled by this Court

(*a*) to clear up the uncertainty and confusion directly relating to a correct decision of the instant case now existing in the minds of courts and commentators and of others as to the scope and effect of the decisions of this Court in said Helmholz and City Bank cases; and

(*b*) to prick out a line in connection with the reasoning in the City Bank case indicating cases which are and cases which are not within the power of Congress to establish a conclusive presumption that property settled by a decedent in trust during his lifetime is part of his estate on his decease for measuring the estate tax on account of a power to change enjoyment, which line "cannot be drawn by generalities but successive points must be fixed by weighing the particular facts." See opinion of Mr. Justice Holmes in the case of *Frost Trucking Co.* v. *Railroad Commission,* 271 U.S. 583, 601.

Some of these conflicting interpretations can be found in *Commissioner* v. *Allen,* 108 Fed. (2d) 961, 965 (Helmholz case interpreted as turning on the power coming to the settlor as one of the beneficiaries and not as the settlor).

Howard v. *United States,* 125 Fed. (2d) 986 (Helmholz case interpreted as turning on the trust indenture becoming terminable by the joint act of all the beneficiaries).

55 Harvard Law Review, 684 (Helmholz case interpreted as based on power to change enjoyment being in "the then living beneficiaries," *i.e.,* beneficiaries living at the date of the death of the settlor).

Section 302 (d) has been in effect, from 1924 to 1936, unmodified so far as the present questions are concerned.

During that period it is to be inferred that numerous trusts have been created with various reserve powers to change enjoyment, the effect of which powers, with respect to Section 302 (d), will not come before the courts until the various settlors shall have deceased.

BRIEF.

Section 302 imposes an estate tax—an excise tax based on the value of property passing from the dead to the living—not a delayed tax on gifts which were completed during the lifetime of the deceased. *Heiner* v. *Donnan*, 285 U.S. 312, 322; *Reinecke* v. *Northern Trust Co.*, 278 U.S. 339.

Section 302 (d) creates a presumption that in certain cases property, legal title to which is not in the estate of a decedent at his death, having been transferred by him during his lifetime, shall nevertheless be regarded as part of his estate for measuring the estate tax. The purpose of Section 302 (d) is to prevent the evasion of tax (City Bank case, p. 91) through transfers in cases where the transferors retain substantial control over the economic interests of the property transferred. That "substantial control" over the property by the settlor is necessary for the creation of the presumption provided for by Section 302 (d) is indicated by the following paragraph from the Report of the Chairman of the House Ways and Means Committee (House Report 179, 68th Congress, First Session, p. 28), referring to said Section 302 (d):

> "Even though the decedent has made the transfers specified in this subdivision, he has retained substantial control over the disposition of the property, through the power to change the enjoyment thereof. Such prop-

> erty interests should therefore fairly be taxed as part of the decedent's estate, particularly since, by virtue of his death, the substantial interest which he had has been wiped out, and to the same extent the property interest of the legal title holder, his transferee, has been increased. This provision is in accord with the principle of section 219(g) of the bill which taxes to the grantor the income of a revocable trust."

It is to be inferred from the above that, where the power of the decedent at the time of his death to change the enjoyment of a property interest in a trust he had created did not constitute "substantial control over the disposition of the property," Section 302 (d) was not intended to apply. Also the City Bank case declares that "there are, however, limits to the power of Congress to create a fictitious status under the guise of supposed necessity."

The facts in the City Bank case showed a transfer in trust clearly within the scope of the presumption, since the settlor in that case retained substantial control over the economic interests in the property after its transfer in trust, as she could change the enjoyment of the trust property with the assent of only one beneficiary, her husband, whose interest was contingent and small in value with reference to all the other interests in the trust. *The instant case is nearly at the opposite pole from the City Bank case and is as if in the City Bank case all the interests whose assents were not there necessary had, in fact, been necessary.*

Even though by its terms said Section 302 (d) did require that the trust property in this case be included as a measure of an estate tax, it should nevertheless be excluded since to include it would cast doubts, to say the least, on the constitutionality of the statute. The statute should not be construed literally, if to do so would give it an unreasonable or unconstitutional application. *Holy Trinity Church* v.

United States, 143 U.S. 457. "A statute must be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional but also grave doubts upon that score." *United States* v. *Jin Fuey Moy*, 241 U.S. 394, 401.

Even if it be admitted that Section 302 (d) might be properly applicable in some cases where tax avoidance was found expressly not to have been the purpose of the transfers in trust, nevertheless it is urged that in conjunction with all the other facts indicating the tenuity of any power in the settlor in this case to change enjoyment, it is important here that the purpose of the trust has been found to have been to avoid friction between the decedent's second wife and his children by his first marriage, and therefore, not to avoid or to evade estate taxes.

Moreover, it would have been impossible for the settlor in this case to have bought off his children, since his own property was much less in the aggregate than the value of any one of his children's interest in the trust estate.

The attenuated nature of the decedent's power to change enjoyment is emphasized if one considers the interests of the three children in the trust property in connection with any such power. In order to change the enjoyment of any one of his three children, the settlor would have had to persuade not only such child but two other children having similar interests and (one of such children being a trustee) another person, also a trustee, but having no beneficial interest in the trust property. For a case where interests in trust property have been treated separately with reference to the application of Section 302 (d) see the case of *Commissioner of Internal Revenue* v. *Bridgeport City Trust Co.*, 124 Fed. (2d) 48. A gift can hardly be regarded as having "strings attached" where the only chance of the donor of recovering back the gift is to persuade the donee to give it back, and where there is no pecuniary inducement to make such gift back and where, as in this case, not only

each child would have had to be persuaded but the other persons as stated above.

Quite apart from the fact that there could be no change in enjoyment without the consent of the owners of practically all the beneficial interests of the trust, it is to be noted that the clause with reference to termination or amendment (clause 12 of the trust instrument (R. 21)) did not give the settlor any power whatever as settlor, and there is no intimation that the settlor was even to initiate any proceedings to terminate or amend. In the case of *Reinecke* v. *Smith*, 289 U.S. 172, and *Chickering* v. *Commissioner*, 118 Fed. (2d) 254, the deceased had virtually a power in gross in that he could have participated in the exercise of any power to change enjoyment even after he had ceased to be a trustee. In the cases of *Witherbee* v. *Commissioner*, 70 Fed. (2d) 696, and *Carkhuff* v. *Commissioner*, 83 Fed. (2d) 626, the deceased, by the terms of the trust, reserved the power to himself to change enjoyment and was not a trustee. Had the deceased in the instant case as trustee, the only capacity in which he had any authority whatever to participate in any change of enjoyment, undertaken to disregard the interests of the beneficiaries of the trust, he would have been violating the rule that no trustee can act in his own interest in conflict with that of the beneficiaries. See Restatement of the Law of Trusts, Section 187 d(6). There is nothing to intimate that the trustees other than the decedent were in any way his agents. "When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them" (Restatement of the Law of Trusts, Section 183), and each trustee must use reasonable care to prevent a co-trustee from committing a breach of trust (Restatement of the Law of Trusts, Section 184). "The trustee is under a duty to the beneficiary to administer the trust solely in the interest of the beneficiary" (Restatement of the Law of Trusts, Section

170). In this case, therefore, any power to change enjoyment residing in the decedent at the time of his death was held by him in a fiduciary capacity, as one of the three trustees of the trust. Had the trust property remained his own, he could have dealt with it in all respects as he liked, but as a trustee any power he had over it must be exercised with the utmost regard for the rights of the beneficiaries, and his power to handle the property on an arm's length basis became non-existent when he created the trust. Had he been disposed in any way to treat the trust property as his own in violation of his duty as a trustee, there were two other trustees and the Massachusetts courts to see that he did not do so, and in addition there were all three of his children together holding practically the entire beneficial interests in the trust, as well as certain grandchildren holding smaller interests therein (see *Nicholson* v. *United States,* 25 Fed. Supp. 424).

Even if Section 302 (d) of the Revenue Act of 1926, applicable in this case, had contained the amendment thereto, namely, the words "in whatever capacity acting," added by the Revenue Act of 1936 (Section 805, Revenue Act of 1936, 49 Stat. 1744-45), or had such amendment had the rather retroactive effect given it by the Circuit Court in this case (R. 55), it is obvious, of course, that the contention of these petitioners herein contained would have been no different, to the effect that no intention can be imputed to Congress to include the corpus of an *inter vivos* trust to measure the estate tax of a settlor unless at the time of his death he had substantial control over it.

Boyden v. *Stevens,* 285 Mass. 176, at 179: "There is an implication, when even broad powers are conferred, that they are to be exercised with that soundness of judgment which follows from a due appreciation of trust responsibility. Prudence and reasonableness, not caprice or careless good nature, much less a desire on the part of the trustee

to be relieved from trouble or from the possibility of making a foolish investment, furnish the standard of conduct." *Corkery* v. *Dorsey,* 223 Mass. 97, 101. See also *Wilson* v. *Wilson,* 145 Mass. 490, 492.

Although it may be unnecessary for these petitioners to refer to the case of *Helvering* v. *Helmholz* as an authority to sustain their contentions herein made, it is nevertheless contended that that case is on all fours with the instant case and, if followed, will result in a reversal of the decision of the Circuit Court of Appeals. In that case the essential facts were that the decedent had transferred certain property in trust, the income to be paid to her for life, and after her death to be paid for life to her appointees by will, and in default of appointment, or after the appointees' death, to her issue, and in default of issue, to other relatives or their issue, and upon termination of the trust the principal was to be paid to the persons then entitled to the income. The trust was to terminate on the death of certain named persons or among other contingencies "upon delivery to the said trustee of a written instrument signed by all of the then beneficiaries . . . declaring said trust term at an end," the quoted words contained in the trust instrument being those relied upon to render the trust fund includable for estate tax purposes. The words "then beneficiaries" have been interpreted in a learned note in the Harvard Law Review (55 Harvard Law Review, 684) as meaning then living beneficiaries, that is, beneficiaries living at the date of the death of the settlor. This interpretation, it is submitted, is the correct one, for had the assent of all the beneficiaries been necessary there would have been no power at all, since many beneficiaries were unborn and unascertained persons, whose assents could not have been obtained at any time prior to the termination of the trust by its express terms. On the basis of this interpretation, the case is on all fours with the instant case in that (*a*)

Section 302 (d) was in effect in identical form in both the Helmholz case and in this case; (*b*) the law of Wisconsin, as it was presumed to exist by this Court in the Helmholz case, was the same as the Massachusetts law applicable to this case, namely, as set forth in Section 338 of the Restatement of the Law of Trusts, "§ 338. This states the law"—see Massachusetts Annotations to the Restatement of the Law of Trusts, Section 338, p. 282; (*c*) the interests of the beneficiaries living at the death of the settlor in the Helmholz case corresponded in the proportion they bore in terms of value to all the interests created by the trust instrument in the trust property to the proportion borne by the interests whose assents would be required to any change in interest bore to all the interests in this case. The Helmholz case was, it is submitted, like this case, one which, were Section 302 (d) to be held applicable thereto, would have been beyond the "limits to the power of Congress to create a fictitious status under the guise of supposed necessity" (City Bank case, p. 92). Moreover, in the instant case, as is pointed out at more length hereinbefore, any power in the settlor to change any interest in the trust could be exercised by him only as trustee, which was not true in the Helmholz case.

It may well be that the Court in the Helmholz case was of the opinion that had Section 302 (d) been held applicable "the individual innocent of evasion" would have been "stripped of his constitutional rights in order to further a more thorough enforcement of the tax against the guilty —a new and startling doctrine condemned by its mere statement and distinctly repudiated by this Court in the Schlesinger (240) and Hoeper (217) cases, involving similar situations." *Heiner* v. *Donnan,* 285 U.S. 312, at 328.

In *Haddock* v. *Haddock,* 201 U.S. 562, 631, Holmes, dissenting, said: "I have heard it suggested that the difference is one of degree. I am the last man in the world to quarrel

with a distinction simply because it is one of degree. Most distinctions, in my opinion, are of that sort, and are none the worse for it. But the line which is drawn must be justified by the fact that it is a little nearer than the nearest opposing case to one pole of an admitted antithesis.

Conclusion of Brief.

No case has been found in which this Court or any other court has held the conditions of Section 302 (d) to be satisfied where the deceased could participate in the change in enjoyment of the trust property only in a fiduciary capacity as is the case here. No case has been found where such conditions have been held to be satisfied where the participation of the deceased in any change of enjoyment has been so circumscribed and attenuated as in this case, requiring for any change of enjoyment the concurrence of three trustees and of the three beneficiaries owning very nearly the entire sum of the beneficial interests in the trust property. Any substantial change in enjoyment in this case would necessarily have involved a substantial change in the beneficial interests of such three beneficiaries and their consent would have been necessary. It is submitted that it is beyond all reason to presume that any such consent could have been obtained. Surely Congress can enact reasonable provisions to prevent the evasion of estate taxes and to that end can create reasonable presumptions. But the presumption held by the court below to have been created by Section 302 (d) in this case is, it is submitted, far outside of any rule of reason, applicable to the prevention of tax avoidance. "Rights guaranteed by the federal Constitution are not to be so lightly treated; they are superior to this supposed necessity. The State is forbidden to deny due process of law or the equal protection of the

laws for any purpose whatsoever." *Heiner* v. *Donnan*, 285 U.S. 312, 325.

A writ of certiorari in this case will, in addition to its bearing hereon, result, it is reasonably to be expected, in establishing or tending to establish the principle on the basis of which many future cases, which it is to be expected will arise hereafter, may be decided. "Tax laws like all other laws are made to be obeyed. They should therefore be intelligible to those who are expected to obey them." *Philadelphia Storage Battery* v. *Lederer*, 21 Fed. (2d) 320, 321, 322, and *White* v. *Aronson*, 302 U.S. 16, at 20. "Numerous cases pending in the courts and the Board of Tax Appeals involving these questions, and the claim that decisions of this Court have not settled the matter, moved us to grant certiorari." Per Roberts, J., in *Hassett* v. *Welch*, 303 U.S. 303, 305.

CONCLUSION.

Wherefore it is respectfully submitted that this petition for a writ of certiorari should be granted.

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